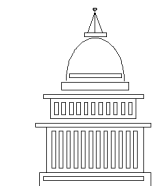




## Local Governmental Auditing and Accounting

# Newsletter

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### Questions or Concerns?

If any entity has questions or concerns regarding budgeting, financial reporting, or compliance with state law or policy, please feel free to call any of the individuals listed above. If we don't have the answer, we can research the question or refer you to the office or individual that can help you! Outside the Salt Lake City area, feel free to use our toll-free telephone number: 1-800-622-1243. You can also e-mail us at the addresses shown above.

## NEW GAGAS INDEPENDENCE STANDARD

On January 25, 2002, GAO issued a new standard on independence (Amendment 3 to Government Auditing Standards.). The new standard deals with a range of auditor independence issues, however the most significant change relates to non-audit or consulting services. This new standard is applicable to all audits for periods beginning on or after January 1, 2003. (Note that originally the effective date was for audits beginning on or after October 1, 2002.) This article will focus on what is generally considered to be a non-audit service; what an auditor must consider when providing non-auditing services; and finally, web sites where the auditor can access more information on the new independence standard.

Section 3.19 of Government Auditing Standards (yellow book) states that non-audit services generally include "performing tasks requested by management that directly support the entity's operations, such as developing or implementing accounting systems; determining account balances; developing internal control systems; establishing capitalization criteria; processing payroll; posting of transactions; evaluating assets; designing or implementing information technology or other system; or performing actuarial studies, or providing information or data to a requesting party without providing verification, analysis, or evaluation of the information or data, and therefore the work does not usually provide a basis for conclusions, recommendations, or opinions on the information or data."

According to the new standard (Section 3.21 of Government Auditing Standards), an auditor of an entity's financial statements can only perform non-audit services for that same entity if the two overarching principles are satisfied. The overarching principles, as defined by the new independence standard, are as follows: (1) audit organizations should not provide non-audit services that involve performing management functions or making management decisions and (2) audit organizations should not audit their own work or provide non-audit services in situations where the non-audit services are significant/ material to the subject matter of audits. If non-audit services do not violate the two over-arching principles the auditor then must follow the seven safeguards as discussed in Section 3.25 to ensure independence. The new standard states that a number of specific non-audit services never will satisfy the two overarching principles. They include maintaining a client's GL and directly posting transactions to the GL. The auditor can prepare basic financial statements only if based on management's chart of accounts and all adjusting, correcting, and closing entries have been approved by management. (The overarching principles must be satisfied.)

It should be noted that an auditor is capable of providing a number of services for a client. However, following the new independence standards may not allow the auditor to perform both audit and non-audit services for the same entity. When this is the case, the auditor must choose which service he/ she will perform.

Every auditor that performs audits of governmental entities in Utah should read and gain an understanding of the new independence standard.

The new GAO Independence Standard is available on GAO's web site at <http://www.gao.gov/govaud/yb01.htm>.

The auditor should then evaluate their clients to see if any independence issues need to be addressed. Many auditors might still have questions about whether or not the services they provide impairs independence. GAO has provided a document entitled *Government Auditing Standards-Answers to Independence Standard Questions* that also should be reviewed.

This document can be accessed from GAO's web site at <http://www.gao.gov/govaud/d02870g.pdf>.

If you have any questions regarding this new standard, you may contact the State Auditor's Office. However, the State Auditor's Office normally does not determine independence issues, and usually will refer your question to the AICPA.

## Reporting Cash and Cash Equivalents



Quite often, we see the presentation of "cash" and "investments" on the balance sheet. With the issuance of GASB Statement No. 9, the proper terminology is now "cash and cash equivalents" grouped as one item and then "investments" appearing directly below.

GASB Statement No. 9 defines cash equivalents as "short-term, highly liquid investments that are both (a) readily convertible to known amounts of cash, and (b) so near their maturity that they present insignificant risk of changes in value because of changes in interest rates." Generally, only investments with maturities of three months or less from the time of purchase meet this definition.

Examples of items commonly considered to be cash equivalents are treasury bills, commercial paper, certificates of deposit, money market funds and cash management pools. Cash purchases and sales of those types of investments generally are part of the entity's cash management activities rather than part of its operating, capital, investing, and financing activities, and details of those transactions should not be reported in a statement of cash flows.

Not all investments that qualify are required to be treated as cash equivalents. An entity should establish a policy concerning which short-term, highly liquid investments (that satisfy the definition of a cash equivalents listed above) it will treat as cash equivalents. An entity should disclose its policy for determining which of those items are treated as cash equivalents. Any change in the policy is a change in accounting principle that should be reported by restating financial statements for earlier years presented for comparative purposes.

GASB's Codification, Section 2450.105, states that "The total amounts of cash and cash equivalents at the beginning and the end of the period shown in the statement of cash flows should be easily traceable to similarly titled line items or subtotals shown in the statements of the financial position as of those dates." Therefore, it is recommended that governments use the term "cash and cash equivalents" on the combined balance sheet in a manner consistent with its use in the statement of cash flows.

Because cash and cash equivalents are grouped together, it will be necessary to add this amount to investments in order to reconcile the numbers listed in the Notes to the Financial Statements under "Deposits and Investments."

## Audit Findings



Audit findings may be divided into four different categories: financial statement findings, yellow book findings, state legal compliance findings, and single audit findings. It is possible for some findings in a certain category to also be findings in another category, e.g., a financial statement control finding would also be a yellow book finding and could be a single audit finding. On the other hand, it is hard to imagine a state legal compliance finding being considered or shown as a single audit finding. Let's discuss each type of finding.

### Financial Statement finding

This is almost always a control finding affecting the accounting system and therefore the financial statements. Usually, this type of a finding would almost always be a yellow book finding as well, and, should therefore, be mentioned in the yellow book report either as a material weakness, a reportable condition, or as an “other matters” finding. Which of these three degrees the finding fits is an auditor’s decision given his/her knowledge of the client and the system under audit. If this control finding affects a system, which also deals with federal funds, it may also be a single audit finding. That may, in fact, frequently be the case.

### Yellow Book findings

These findings are either a control finding, as discussed above, or a compliance finding. A compliance finding deals with the client’s compliance with laws and regulations, the non-compliance with which could result in a material misstatement of the financial statements. The laws and regulations would include federal laws, e.g., social security and payroll taxes; and state laws, e.g., budget requirements. Therefore, state legal compliance finding should be mentioned in the yellow book report.

### State Legal Compliance findings

These findings deal only with compliance with state laws as shown in the State Legal Compliance Audit Guide. These are never findings on internal control. These are never based on the auditor’s opinion of what is right or wrong, but strictly on what the Audit Guide states. Thus, a finding on the fact that a client does not have 100 percent of their deposits federally insured is not an appropriate state legal compliance finding, because the Audit Guide does not require that. State legal compliance findings should be mentioned in the Yellow Book report, usually as an other compliance matter. State legal compliance findings should never be included as single audit findings.

### Single Audit findings

Single audit findings may, and often will, include yellow book findings. Beyond yellow book findings, single audit findings will include control findings on the control system for federal programs and compliance findings on major federal programs. Single audit findings may include questioned costs. If the testing of internal control over major programs does not support a low level of control risk, the auditor must write at least a reportable condition.

## **CONTRACT RETAINAGES**

The Utah Code limits the percentage of the retention proceeds withheld on construction contracts to 5% of payments due. This limitation applies to local government contracts as well as private contracts. Amounts retained must be invested and interest earned accrued to the benefit of the contractor

Recently, we have learned that some contractors have requested local governments to withhold more than 5%. At first blush, this seems strange. However, they have learned that local governments earn a higher rate of interest in the PTIF than can be earned at the local bank.

Utah Code Section 13-8-5 explicitly states that contract retainages on construction projects cannot exceed 5% of payments due. This requirement also precludes withholding 5% of the entire contract up front since the retainage is limited to 5% of the payments made.

Local governments should ensure that they are in compliance with these restrictions as soon as possible.

## **E-mail Address Changes**

The e-mail addresses for the local government division have changed. The new e-mail addresses are as follows:

MacRay Curtis, Director- Counties  
[macraycurtis@utah.gov](mailto:macraycurtis@utah.gov)

Richard Moon, Cities & Towns  
[richardmoon@utah.gov](mailto:richardmoon@utah.gov)

Eckhard Bauer, Special Districts  
[ebauer@utah.gov](mailto:ebauer@utah.gov)

Kent Godfrey, School District, NPO  
[kgodfrey@utah.gov](mailto:kgodfrey@utah.gov)

Also if you have been e-mailing the Survey of Local Government forms (UT-Forms) to the State Auditor’s Office, that e-mail address has changed to [utforms@utah.gov](mailto:utforms@utah.gov).

Our web site, <http://www.sao.state.ut.us>, has not changed.



## **Survey of Local Government Finances forms also called UT or Census forms**

A reminder to entities, usually counties and municipalities, that have created entities in accordance with *Utah Code* 17A-2 (special districts).

If the entity is reported by you on your financial statements as a discrete component unit, do not include them in your census form. These entities should be audited separately and submit their own census form. If you include them on your form, they will be double counted, which is not what is wanted. Therefore, do not include them.

If the entity you created is a blended component unit, do include them on your census form.

We have incorporated this information in the census forms instructions.